

# Treasury Management activity and treasury and prudential indicators 2022/23

## 1. Introduction

- 1.1 The treasury management service is an important part of the overall financial management of the council. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions.
- 1.2 Strict regulations, such as statutory requirements and the CIPFA treasury management code of practice (the TM Code) govern the council's treasury activities, and the Prudential Code and MHCLG Investment Guidance non-treasury investments.
- 1.3 The Council holds a substantial amount of Investment property (non-treasury investment) and has a large capital programme which directly impacts on the treasury management decisions the Council may make.

## 2. Treasury management activity

- 2.1 The council has an integrated capital and investment strategy and manages its cash as a whole in accordance with its approved strategy. Therefore, overall borrowing may arise because of all the financial transactions of the council (for example, borrowing for cash flow purposes) and not just those arising from capital expenditure reflected in the Capital Financing Requirement (CFR).

### Investments

- 2.2 The then Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance requires local authorities to focus on security and liquidity rather than yield.
- 2.3 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20 December 2021. These define treasury management investments as:

*“investments that arise from the organisation’s cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business”.*

2.4 Both the CIPFA Code and government guidance requires local authorities to invest funds prudently, and to have regard to the security and liquidity of investments before seeking the highest rate of return, or yield. The main objective, therefore, when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

2.5 The Bank of England increased the official bank rate to 4.25% during the financial year, starting at 0.75% in March 2022. Inflation remained stubbornly high throughout the period. There was a lot of uncertainty in the financial markets, and Arlingclose reduced the recommended investment duration to 35 days for unsecured bank investments as a precautionary measure. Local authorities remain under financial pressure but Arlingclose continue to take a positive view of the sector. Higher returns on cash investments have made a positive addition to the General Fund.

2.6 Security of capital remains our main objective when placing investments. We maintained this during the year by following our investment policy, as approved in our treasury management strategy 2022/23, which defined “high credit quality” counterparties as those having a long-term credit rating of A- or higher.

2.7 Investments during the year included:

- investments in AAA rated constant net asset money market funds
- call accounts and deposits with banks and building societies systemically important to each country’s banking system. We do have some investments with overseas banks, but in sterling
- other local authorities
- corporate bonds
- covered bonds

- pooled funds without a credit rating, but only those subject to an external assessment

## 2.8 We divided our investments into three types

- short-term (less than one-year) internally managed cash investments
- long-term internally managed investments
- externally managed funds

## 2.9 Cash balances consisted of working cash balances, capital receipts, and council reserves.

2.10 The table below shows our investment portfolio, at 31 March 2023, compared to 31 March 2022. **Appendix 4** contains a detail schedule of investments outstanding at the end of the year.

Investment details	Balance at 31-03-22 £m	Weighted Avg Return for Year	Balance at 31-03-23 £m	Weighted Avg Return for Year
<b>Internally Managed Investments</b>				
Fixed Investments < 1 year to cover cash flow	41.00	0.46%	60.20	0.70%
Corporate bonds	4.00	0.14%	5.16	1.54%
Long term bonds	15.00	0.29%	10.05	2.53%
Notice Accounts	3.00	0.40%	3.13	2.27%
Call Accounts	2.25	0.01%	0.00	0.25%
Money Market Funds	31.90	0.07%	3.90	2.01%
Long term investments > 1 year	39.40	0.40%	0.00	0.70%
<b>Externally Managed Funds</b>				
Funding circle	0.21	10.90%	0.10	5.17%
Cash plus	5.00	0.00%	0.00	0.00%
CCLA	7.67	4.41%	6.42	4.58%
Fundamentum	2.07	1.65%	1.88	4.93%
RLAM	2.25	4.79%	2.13	4.92%
M&G	0.00	3.25%	0.00	0.00%
Aegon	0.00	0.00%	2.41	2.43%
Schroders	0.77	7.31%	0.73	6.08%
UBS	2.11	4.71%	1.77	5.49%
<b>Total Investments</b>	<b>156.63</b>	<b>0.65%</b>	<b>97.87</b>	<b>1.62%</b>

- 2.11 Our level of investments decreased during 2022/23, and we achieved a higher return than last year. Interest rates have increased to help alleviate the impact of Inflation in the Economy. The portfolio will have lower rates until fixed investments mature and can be reinvested at the higher rates. FRN Bonds in the main have a quarterly reset date and will increase sooner than fixed term deposits with a maturity date, and other variable rate investments increase with base rate increases.
- 2.12 The Councils also holds £9.1 million equity investments in Guildford Holdings Ltd and invested £19 million in North Downs Housing Ltd.
- 2.13 We are earning an interest return of 5.5% on the investment in North Downs Housing, as per the loan agreement. This is higher than the return earned on treasury investments but currently reflects the additional risks to the Council of holding the investment, but is more in line with the Bank of England base rate.

#### **Security of investments**

- 2.14 Counterparty credit quality was assessed and monitored with reference to credit ratings; financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices; financial statements; information on potential government support and reports in the quality financial press.
- 2.15 We also considered the use of secured investment products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.
- 2.16 The minimum long-term counterparty credit rating for 'high quality counterparties' approved for 2022-23 was A-/A3 across all three main credit rating agencies (Fitch, S&P, and Moody's).
- 2.17 The strategy set different limits for different counterparty credit ratings both in maximum duration and exposure in monetary terms.
- 2.18 We also can invest in non-rated institutions subject to due diligence.

#### **Liquidity of investments**

- 2.19 In keeping with the MHCLG's Guidance on Investments, the council maintained a sufficient level of liquidity using money market funds, call

accounts, the maturity profile of fixed investments and short-term borrowing from other local authorities.

- 2.20 We use PSLive as our daily cash flow forecasting software to determine the maximum period for which funds may prudently be committed.

### **Yield of investments**

- 2.21 The council sought to optimise returns commensurate with its objective of security and liquidity. The Bank of England base rate has increased during the year: please refer to paragraph 8 in appendix 9 of the Arlingclose Economic background commentary.
- 2.22 We invested in longer-term covered bonds, which increased the return of the portfolio and the duration. Bonds can be sold in the secondary market should we need the liquidity, and the variable rate bonds reset every quarter allowing increases in interest rate in line with the market increases.
- 2.23 The council's budgeted investment income for the year was £1.278 million and actual interest was £1.9 million, at a weighted average yield of 1.62% (excluding North Downs Housing).

### **Externally managed funds**

- 2.24 We estimate to have cash balances over the medium-term (our "core" cash as identified in the Councils liability benchmark), and as such we have continued investing in pooled (cash-plus, bond, equity, multi-asset and property) funds. These funds have allowed us to diversify into asset classes other than cash without the need to own and manage the underlying investments. These funds operate on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short term. All of our pooled funds are in the respective funds distributing share class, which pay out the income generated. They have no defined maturity date, but are available for withdrawal, some with a notice period.
- 2.25 For fixed income bond investors, 2022 was a very difficult year - bonds had their worst year of performance in several decades; long-term government bonds had their worst year ever as central banks delivered larger interest rates hikes than initially expected and promised more to

combat inflation. As policy rates rapidly rose from very low levels, bond investors suffered large crystallised or unrealised losses from rising sovereign and corporate bond yields (i.e. falling prices) as well as from widening credit spreads as concern grew over the risk of defaults in a recessionary environment. The return on the All-Gilts index was -16.3% over the 12 months to March 2023. Negative yielding bonds all but disappeared globally.

- 2.26 UK and global equities remained volatile against a backdrop of high and sticky inflation, rapid policy rates tightening and an increasing risk of recession. There was a large sell-off in global equities in April, and again in June and September for both UK and global equities. The total return on the FTSE All Share index for the 12 months ending March 2023 was 2.9% and 5.4% for the FTSE 100.
- 2.27 The negative correlation between bonds and equities, which had featured for some years, turned positive in 2022 as both bonds and equities sold off simultaneously against an outlook of sticky inflation and high interest rates. Simultaneously, tighter financial conditions, higher bond yields and challenges in some segments of commercial real estate (e.g. offices post-COVID, high street shops and shopping centres) saw commercial property values fall during 2022, with a large fall in the final calendar quarter.
- 2.28 Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.
- 2.29 The details of our external funds are show in the table at para x.

### **Borrowing and debt management**

- 2.30 The council's debt portfolio is detailed in the table below. Our loan portfolio decreased by £14 million due to repaying some of the short-term loans (£23.5 million), partly replacing with longer-term PWLB loans for WUV (£9.4 million). Short-term borrowing rates increased in line

with the Bank of England base rate, as such the average weighted interest rate is higher than 2021/22.

		<b>31 March 2022 (£'000)</b>	<b>Average Rate</b>	<b>31 March 2023 (£'000)</b>	<b>Average Rate</b>
Fixed Rate Debt	PWLB	170,235	3.22%	179,599	3.22%
Variable Rate Debt	PWLB	0	0.00%	0	0.00%
Long-term	LAs	0	0.00%	0	0.00%
Temporary borrowing	LAs	138,500	0.17%	115,000	0.51%
<b>Total Debt</b>		<b>308,735</b>	<b>1.73%</b>	<b>294,599</b>	<b>2.51%</b>

- 2.31 Our primary objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should our long-term plans change being a secondary objective.
- 2.32 We also have short-term loans outstanding at the end of the year which we took out for cash flow purposes, from other local authorities. Temporary and short-dated loans borrowed during the year from other local authorities remained affordable and attractive.
- 2.33 Affordability and the “cost of carry” remained important influences on our long-term borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would be invested at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained lower than long-term rates, the council determined it was more cost effective in the short-term to use internal resources and borrow short-term to medium-term instead.
- 2.34 A new HRA PWLB rate of gilt yield plus 0.4% (0.4% below the currently available certainty rate) was announced on 15th March 2023. This discounted rate is to support local authorities borrowing for Housing Revenue Accounts and the delivery of social housing and is expected to be available from June 2023, initially for a period of one year.
- 2.35 The Councils borrowing position is monitored regularly as to whether it is more beneficial to externalise borrowing now or whether to continue internal borrowing based on predicted future borrowing costs (which are likely to be higher), however the availability of internal borrowing is severely reduced and the high value capital projects currently approved

will require external funding. Arlingclose assist us with this 'cost of carry' and break-even analysis.

- 2.36 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management. Misuse of PWLB borrowing could result in the PWLB requesting that Council unwinds problematic transactions, suspending access to the PWLB and repayment of loans with penalties.
- 2.37 Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

### **3. Treasury and prudential indicators**

- 3.1 The Local Government Act 2003 requires local authorities to have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent, and sustainable, and that treasury decisions are taken in accordance with good professional practice. To demonstrate the Council has fulfilled these objectives, the Prudential Code sets various indicators that must be set and monitored each year.
- 3.2 The CFO confirms that we have complied with our prudential indicators for 2022/23, which were approved in February 2022 as part of the treasury management strategy statement. The CFO also confirms that we have complied with our treasury management policy statement and treasury management practices during 2022/23.

#### **Balance sheet and treasury position prudential indicator**

- 3.3 The capital financing requirement (CFR) measures the council's underlying need to borrow for a capital purpose. Over the medium-term, borrowing must be only for a capital purpose, although in the short-term, we can borrow for cash flow purposes, which does not affect the CFR.
- 3.4 The council's CFR for 2022/23 is shown in the following table

<b>Capital Financing Requirement</b>	<b>2022/23 Approved Estimate £000</b>	<b>2022/23 Revised Estimate £000</b>	<b>2022/23 Actual £000</b>
<b>HRA</b>			
Opening balance (01 Apr 22)	207,024	199,204	199,204
Movement in year: Unfinanced cap exp	10,000	0	0
<b>Closing balance (31 Mar 23)</b>	<b>217,024</b>	<b>199,204</b>	<b>199,204</b>
<b>General Fund</b>			
Opening balance (01 Apr 22)	156,891	156,891	157,217
Movement in year: Unfinanced cap exp	90,314	37,000	26,034
Movement in year: MRP	(1,344)	(1,344)	(1,527)
<b>Closing balance (31 Mar 23)</b>	<b>245,861</b>	<b>192,547</b>	<b>181,724</b>
<b>Total</b>			
Opening balance (01 Apr 22)	363,915	356,095	356,421
Movement in year: Unfinanced cap exp	100,314	37,000	26,034
Movement in year: MRP	(1,344)	(1,344)	(1,527)
<b>Closing balance (31 Mar 23)</b>	<b>462,885</b>	<b>391,751</b>	<b>380,928</b>
Balances and Reserves	(159,888)	(159,888)	153,140
<b>Cumulative net borrowing requirement / (investments)</b>	<b>302,997</b>	<b>231,863</b>	<b>534,068</b>

- 3.5 The GF unfinanced capital expenditure mainly relates to WUV, transport schemes and loan / equity to North Downs housing. This is lower than budgeted because of the slippage in the capital programme – we projected some slippage during the year, which is shown by the revised estimate (as in the strategy report presented to Council in February 2023) and is reflected in the 2022/23 MRP budget.
- 3.6 We budgeted an underlying need to borrow of £158 million for 2022/23, and our actual underlying need to borrow was £26.3 million because of slippage in the capital programme and also a higher amount of capital receipts/grants than anticipated.

#### **Gross debt and the CFR**

- 3.7 We monitor the CFR to gross debt continuously to ensure that, over the medium term, borrowing is only for a capital purpose and does not exceed the CFR. This is a key indicator of prudence. We will report any deviations to the CFO for investigation and appropriate action. The following table shows the council is in a net internal borrowing position and gross debt does not exceed the CFR over the period.

<b>Gross Debt and the CFR</b>	<b>2022/23 Actual £000</b>
General Fund CFR	175,040
HRA CFR	199,204
<b>Total CFR (at 31 March)</b>	<b>374,244</b>
Gross External Borrowing	(294,599)
<b>Net (external) / internal borrowing position</b>	<b>79,645</b>

- 3.8 Actual debt levels are monitored against the operational boundary and authorised limit for external debt, detailed in paragraph 3.20 to 3.25.
- 3.9 We are showing as being internally borrowed up to £80 million in at the end of March 2022.

### Capital expenditure prudential indicator

3.10 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on council tax or housing rent levels for the HRA.

3.11 The following table shows capital expenditure by project in the year, compared to the original estimate approved by the Executive in January 2022.

Projects	Original Estimate (£'000)	Actual (£'000)	Variance (£'000)
<u>Housing Revenue Account</u>			
HRA Capital Programme	60,190	26,355	(33,835)
<b>Total Housing</b>	<b>60,190</b>	<b>26,355</b>	<b>(33,835)</b>
<u>General Fund</u>			
Infrastructure	3,250	259	(2,991)
Strategic Property	24,992	909	(24,083)
Ash road bridge & Footbridge	19,169	2,820	(16,349)
NDH/GHL	1,783	2,429	646
Midleton redevelopment	5,557	3,549	(2,008)
WUV	52,730	19,566	(33,164)
Other General Fund Projects	6,144	5,913	(231)
Provisional schemes	44,486	0	(44,486)
<b>Total General Fund</b>	<b>158,111</b>	<b>35,445</b>	<b>(122,666)</b>
<b>Total Capital Programme</b>	<b>218,301</b>	<b>61,800</b>	<b>(156,501)</b>

3.12 The table shows that there was significant slippage in the capital programme. This was mainly over a few larger schemes including:

- WUV because of the discussions with Homes England and the affordability mitigation plan

- Shaping Guildford Future – it was identified the works were not at a stage where they can be capitalised.
- Property acquisitions – in light of the changes to the PWLB lending arrangements the Council is only pursuing purchases for strategic purposes and there were no such properties forthcoming in the year.
- provisional schemes were re-profiled during the year, and include:
  - vehicles and plant purchase – discussions around the fuel type of the new vehicles delayed the spend
  - Loan and Equity purchase into North Downs Housing – this was delayed pending discussions around the future of the company
  - Guildford West

3.13 The following table shows the financing of capital expenditure in the year, compared with the original approved estimate.

<b>CAPITAL EXPENDITURE - SUMMARY</b>	<b>Original Estimate (£'000)</b>	<b>Actual (£'000)</b>
<b>General Fund Capital Expenditure Financed by:</b>		
- Borrowing/Use of Balances	(108,801)	(26,082)
- Capital Receipts	0	(286)
- Capital Grants/Contributions	(47,472)	(6,802)
- Capital Reserves/Revenue	(1,838)	(2,275)
<b>HRA Capital Expenditure Financed by:</b>		
- Capital Receipts	(8,540)	(2,819)
- Capital Reserves/Revenue	(51,650)	(23,536)
<b>Financing - Totals</b>	<b>(218,301)</b>	<b>(61,800)</b>

3.14 GF borrowing was less than budgeted because of slippage in the capital programme, which reduced the need for internal borrowing in the year.

**Ratio of financing costs to the net revenue stream prudential indicator**

3.15 This is an indicator of affordability and highlights the revenue impact of capital expenditure by identifying the proportion of the revenue budget required to meet the financing costs associated with capital spending. Financing costs include interest on borrowing, MRP, premium or discount on loans repaid early, investment income and depreciation where it is a real charge.

3.16 Depreciation is not a real charge to the GF but has been to the HRA since April 2012.

3.17 The ratio is based on costs net of investment income.

3.18 The net revenue stream for the GF is the total budget requirement and for the HRA is total income. The total budget requirement for the GF used is the 2022/23 budget.

	<b>2022/23 Original Estimate</b>	<b>2022/23 Actual</b>
General Fund	8.42%	9.25%
HRA	32.49%	30.25%

3.19 The GF is higher than originally estimated because the interest payable to HRA on its balances was higher than estimated due to the increase in interest rates. HRA is lower because HRA interest on reserves was higher than budgeted due to the increase in the investment rates.

**The authorised limit prudential indicator**

3.20 The Local Government Act 2003 requires the council to set an affordable borrowing limit, irrespective of the indebted status. This is a statutory limit, which we cannot breach.

3.21 The limit is the maximum amount of external debt we can legally owe at any one time. It is expressed gross of investments and includes capital

expenditure plans, the CFR and cash flow expenditure. It also provides headroom over and above for unexpected cash movements.

3.22 The limit was set at £553 million for the year and the highest level of debt was £314 million.

3.23 We measure the levels of debt on an ongoing basis during the year for compliance. The CFO confirms there were no breaches to the authorised limit in 2022-23.

#### **The operational boundary prudential indicator**

3.24 The operational boundary, based on the same estimates as the authorised limit, reflects the most likely, prudent but not worst-case scenario. It does not allow for additional headroom included in the authorised limit.

3.25 The limit was set at £494 million for the year and the highest level of debt was £314 million.

#### **Maturity structure of borrowing treasury indicator**

3.26 The aim of this indicator is to control our exposure to refinancing risk (large concentrations of debt needing refinancing at once).

31 <sup>st</sup> March 2022 £'000	Loans Maturity (Liquidity Risk)	31 <sup>st</sup> March 2023 £'000
134,136	Less than 1 year	126,545
10,318	Over 1 year but not over 2 years	11,545
32,227	Over 2 years but not over 5 years	24,636
58,182	Over 5 years but not over 10 years	62,727
25,636	Over 10 years but not over 15 years	909
32,435	Over 15 years but not over 20 years	57,435
10,800	Over 45 years	10,800
303,734	Total	294,597

3.27 The above table shows the amount of debt maturing in each period and its percentage of total fixed rate loans. That less than 12 months is mainly made up of short-term borrowing.

**Actual external debt treasury indicator**

3.28 This indicator comes directly from our balance sheet. It is the closing balance for actual gross borrowing (short and long term) plus other deferred liabilities. It is measured in a manner consistent for comparison with the authorised limit and operational boundary.

3.29 Actual external debt (as per 3.7) stood at £295 million.

**Upper limit for total principal sums invested over 1 year**

3.30 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the council having to seek early repayment of the sums invested.

3.31 Our limit was set at £50 million we ended the year with exposure of £35 million.

3.32 As mentioned earlier in the report, many of our long-term investments are covered bonds, which can be sold on the secondary market. There could be a price differential if they were sold, but it is unlikely to be material.